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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE rise in the markets, which has been the sensation of the business news during June, exceeds anything that even the optimists had expected.

When the Spring season passed without a check to the downward trend of prices and trade, the natural assumption was that the Summer would be an even slacker time; and hopes of improvement were accordingly centered on the Fall. However, the markets have not waited. Just what gave the start to the rise is hard to say, but there were indications during the first half of the month that the Summer might not be as bad as feared; and in commodities the lower prices, further curtailment of production, and reduced stocks in consumers' hands provided exactly the same conditions which in past depressions had induced new buying and started an upward movement.

In any event, the rise found more people prepared to go along with it than had seemed likely. The short interest in the stock market was large, relative to the volume of trading, and other buyers have been backing their judgment that business will improve. A considerable number of manufacturers evidently were in need of staple commodities, or reached the opinion about the same time that a turn was in the making.

Whether the price advances are maintained or not, they have unquestionably spread encouragement and hope. This is true abroad as in this country. The trend of business abroad, and of international trade, has been slowly downward, and the general view is that the slump in the United States has been the chief depressing factor. Many have feared that the drop would become steeper unless the situation here soon turned for the better. On the other hand, if the improvement in the American markets signifies a business pickup the situation abroad will be supported, by the check to the price decline in international commodities, greater purchases of foreign products, and increased confidence.

Perhaps the chief danger to guard against is that extravagant expectations will be raised before there is confirmation that a genuine turn is occurring. If buying is overdone, there will be another slump. If hopes rise too far, and are not fulfilled, a relapse into pessimism and distrust will inevitably follow. Moreover, a too confident assumption that the road is clear would weaken the determination to deal with the difficulties that are in the way of a lasting recovery.

However, we do not think that business men are disposed to expect too much of the present situation. They know that buying spurts can die down as suddenly as they begin, and will do so if the goods bought do not move readily into consumption, with a profit to those who make and distribute them. They know that prospects for the capital goods industries, railroad, utility and factory equipment, and for factory and commercial construction, are not encouraging, so far as can now be seen; and that most analysts of the business situation limit their expectations of Fall improvement chiefly to the textiles and other consumers' goods. They know, moreover, that the problems of restoring purchasing power and reviving enterprise and capital investment are almost incomprehensibly complex; and there is general doubt that early solutions are in prospect, such as would seem necessary for a broad and rapid recovery.

For these reasons we think that business men will be satisfied with a slow uptrend, provided there is indubitable evidence that a start is really made. This country cannot build prosperity on consumers' goods alone. But there must be a start somewhere, and it comes usually from exhaustion of stocks of apparel and other articles of short life which are used up faster than they are replaced. In the normal sequence the move broadens gradually into capital goods, unless it is sidetracked or blocked by interferences. No one can see around all the corners ahead, and the practical attitude is to judge the situation as the corners are reached.

Consumers' Goods Improvement Expected

The chief reasons for expecting improvement in consumers' goods are the curtailment of pro-

duction below consumption for some months past, the reduction of inventories, particularly those held by retailers and distributors, and the lower prices. Department store inventories at the end of May were 9 per cent below a year ago, and hardly above the 1935-36 plateau from which the rise started. If forward commitments for merchandise were included the decrease would be much greater. Similar reductions have been made by other retailers. This is an average figure; the reduction in apparel lines has been greater than average, and the cut in furnishings and other durable goods smaller.

Retailers last Fall and Winter sold considerably more goods than they bought, supplying the difference out of inventory and commitments. For the last quarter this year, they will probably buy about as much as they sell, and if sales hold around 8 to 10 per cent below last year, many will buy more merchandise than they did last Fall. Department store sales during the four weeks ended June 18, according to the Federal Reserve reports, were 15 per cent below a year ago, and the largest mail order house in the same period was off 19. The percentage of decline may widen in the Summer, but it is safe to say that it will narrow later when the comparisons will be with a lower level.

Another element in the outlook is that consumer buying power will be helped by direct Government payments, which will be greater both through relief channels and to farmers than in the same period of 1937; and by the increase in Government spending through other channels, including grants for an estimated $600,000,000 of public works on which construction is intended to start during the Summer. The Government is increasing its direct purchases of commodities, through the W.P.A., Surplus Commodities Corporation, and other agencies. The forthcoming purchase of $10,000,000 of men's clothing, for relief distribution, is an important example of the use of public funds to distribute inventories. With the help of Government payments, farm income, which in the first five months of the year was 13 per cent under a year earlier, is not expected to drop much more, either in comparison with 1937 or with usual seasonal trends.

The Government spending, financed by what may be a record deficit, is assuredly not favorable in the long view, and even for the short term there is considerable opinion that it frightens away more spending by private business than it provides through public channels. However, if other factors turn the trend upward the public money will help it along, while the money lasts.

Retail Prices Lower

Finally, although incomes are down each dollar of income will buy more than it would a year ago. Prices of retail merchandise are lower on the average by 7 to 10 per cent, according to the best evidence available. Retail food prices are down 9 per cent. These reductions, made possible by lower-priced materials, economies, sacrifice of profit and in some cases wage and salary cuts, stretch the consumers' dollar to cover more goods. Thus they help toward balancing price relationships, upon which buying power and trade depend. There never has been recovery from a major depression without reducing prices to levels where goods would sell.

The unfavorable capital goods outlook need not prevent a consumers' goods improvement. If demand for goods increases an increase in production and employment will soon follow, and buying power will be on the rise, at least in these industries. This is the upward spiral, which makes improvement cumulative.

A good many business observers have analyzed the Fall prospect along the lines described, and the June developments have provided indications of its correctness. The cotton goods business has been phenomenally large. In one week, ended the 25th, sales of print cloths are estimated to have equalled about six weeks' production, at current rates. Volume in other lines broadened encouragingly, and buyers unhesitatingly paid higher prices, at which they had hitherto balked. These orders have relieved many mills of excessive inventories, and are already leading to some improvement in operations. Business in rayon fabrics has also broadened.

The Steel Price Cut

The cut of 7 to 17 per cent in steel prices, announced by the U. S. Steel Corporation June 24 and followed by other producers, is an important and favorable development. A reduction as drastic as this will permit lower prices for many manufactured goods in which steel is a basic material. The natural result should be the sale of more goods and the use of more steel. Almost from the beginning of the depression many steel buyers have expected that prices would eventually weaken, and in recent months concessions under published quotations had unsettled the markets. The price cut recognizes this unsettlement and removes a chief obstacle to a greater flow of business.

Evidently, too, the cut is well timed. Recent steel news makes it appear that the situation is slowly mending. A slight improvement in miscellaneous orders, reflecting reduction of inventories, has supported the operating rate against the usual seasonal decline; and from 26 per cent at the beginning of the month it has risen above 28, according to the Institute's estimates. A 28 per cent rate is nothing to be very cheerful about, and the prospective buying from the big industries, which are now most depressed, is not great. Nevertheless, the

evidence of a turn is important, and has raised the spirits of the industry.

Whether the price cut will lead to a cut in wage rates remains to be seen. Steel makers have been emphatic in their opinion that prices could not be reduced without lower wage rates, and the Steel Corporation has made it clear that it reserves liberty of action on wages. Most of the steel companies have been operating at a loss throughout this year and if business does not pick up substantially their losses will be increased by the price cuts. Manifestly their policy is to give the situation every chance to work out. Of course they cannot give employment indefinitely while incurring severe losses, and in the general interest the amount of work that can be given should be the governing factor.

Automobiles and Building

Reports from the automobile industry have changed little, but if anything sales and assembly schedules have been a little better than looked for. The June output is estimated around 170,000 vehicles compared with 210,000 in May and 521,000 a year ago. The curtailment of production has reduced field stocks steadily, and the cleanup of old models before Fall will be thorough. The major companies will begin to close down assembly lines for the changeover period about the middle of July, and according to General Motors plans the shutdown will last three weeks longer than in 1937, when the changeover was the quickest in the industry's history. Expectations for the 1939 model year are modest and preparations for it have been conservative, but of course expectations are subject to change and if business improves through the Fall it is not likely that the automobile industry will lag behind.

The figures of building contracts awarded have been turning more favorable. The total in May, according to the Dodge reports, was 16 per cent above a year earlier, the first time that a gain had been shown. A few substantial public works contracts helped the figures but residential building was down less than 1 per cent. For the first half of June the figures compared less favorably with 1937, due to a bulge in that year; but the residential totals declined less than seasonally from May.

Expectations as to the amount of residential building have changed for the better during the last few months. This is partly because the volume of mortgages offered to the Federal Housing Administration for insurance has held up at a record high level, and partly because many builders are offering attractive small houses at attractive prices which make them available to families of lower income than in the past. Economies which have made these prices possible include lower financing and carrying charges, favorable materials purchases, and efficiency gained by concentrating on such construction. The prospect should not be exaggerated; it is sufficient to say that building is not depressed as greatly as many feared. The Dodge Service suggests that total construction this year may be about equal to 1936 and 8 per cent below 1937. This estimate signifies expectation of improvement hereafter, for the figures thus far have not been as good.

The Improvement in Commodity Markets

Prices of staple commodities have strengthened during the past month, and this is one of the developments from which business may justifiably draw encouragement. Of course there can be no assurance that the bottom has been turned and an upward trend established until the business curve also has turned upward, signifying a rising consumption; for buying spurts in materials will be short-lived unless the goods made from them are being sold and consumed. Moreover, it is much too early to say that confidence in forward commitments is being restored. Nevertheless there are more elements of strength in staple commodity markets than heretofore, chiefly the further curtailment of production of industrial raw materials, reduction of stocks in consumers' hands, and the effect of Government loans and purchases in supporting farm products.

The decline in staple commodity prices in this depression has been greater than ever before witnessed in as short a period, except 1920-21, which was largely a commodity depression. The drop in the price index of the Bureau of Labor Statistics, which is the most widely published index in this country, has been only 12 per cent since the peak on April 3, 1937, but this index of 813 commodities includes a wide variety of finished goods and is far from giving a true picture of the raw materials situation. The basic commodities fluctuate more widely. They are more sensitive to business conditions and themselves influence business conditions more, for they represent the purchasing power of hundreds of millions of producers, and are the chief element in international trade.

Moody's price index, which is based on fifteen staples, made a high in April, 1937 of 228 (December 31, 1931=100) and at the beginning of June this year was down to 130. This is a decline of 43 per cent. In the equivalent fifteen months' period after the 1929 peak the decline in this index was 30 per cent.

The speed of this decline reflects the sharpness of the curtailment in buying when the depression began. Prices of these commodities had risen from the middle of 1936, when the index was around 165, to the peak of 228 in April, 1937; and on the rise manufacturers laid in stocks of materials which quickly be-

came burdensome as their sales fell away. For the past twelve months or so the industries have been running largely on previous inventories and commitments, with a minimum of orders to fill in, and their new purchases have run substantially below their sales and deliveries.

This policy put the burden of carrying stocks of raw materials on the producers and dealers, and visible stocks have climbed rapidly, particularly in the metals, rubber and wool, and in cotton due to the large crop. This is the weakness in the commodity position at present.

Rapid Curtailment of Production

On the other hand, producers have been quicker to react to the change and to curtail their production than ever before. All the markets, except certain agricultural products, give evidence of this. Domestic production of refined copper in May was 50 per cent smaller than in May of last year and will decline more hereafter, as mining operations have been cut sharply during the past month. This is a substantially more rapid curtailment than occurred between the Summer of 1929 and the Summer of 1930, when the drop was less than 30 per cent. In zinc, if estimates of 30-33,000 tons for June production prove correct, this will represent a drop of 40-45 per cent from the peak month of May, 1937, against a comparable reduction in 1929-30 of 25 per cent. The allotted world shipments of rubber in July, giving effect to the reduction in the export quotas to 45 per cent of the base allowance, will be only 58,000 tons, a cut of 48 per cent from the peak in July last year. Rubber shipments were reduced hardly at all during the first twelve months of the 1929 depression. The same comments apply markedly to tin, where export quotas have been cut from 110 to 45 per cent of standard; and in lesser degree to domestic lead production and output of all the non-ferrous metals in foreign countries.

Naturally curtailment as sharp as this should limit the duration of the price decline, for it hastens the correction of the market position. At the beginning of June prices had dropped for fourteen months. The decline after the 1929 peak ran for 47 months, according to the Moody index, and the total drop was 68 per cent; but for many reasons, both in the general economic situation and in the commodity markets themselves, we do not fear a repetition of that experience. The existence of international schemes for regulating production and shipment of commodities, in a degree never before known, and of government intervention to hold commodities off the market and peg prices on behalf of producers, is proof against another price collapse so far as the foreseeable future is concerned. Whether the reduction in output is natural or artificial, sound in principle or unsound, it works to the same end in improving the market position while the restriction is effective.

The position is being improved from the other side also. The long abstinence from buying has enabled the industries which consume basic materials to reduce their stocks and it is only a question of time before surpluses are generally worked off. Purchases then must rise to equal sales. The large stocks in producers' hands will not be a barrier to price improvement once demand resumes. Price history shows that however large these stocks may be, prices tend to strengthen once they begin to run down, which is an incontrovertible sign that demand is exceeding production. It is not possible to say of all commodities that the rise of visible stocks has been checked, or even that it will be checked shortly. Nevertheless, in many markets the period of accumulation seems to be about over, and this will be true of others as time goes on.

In the agricultural commodities production is not so readily responsive to prices, for the weather is uncontrollable and farmers are not so prone to cut output as promptly. However, government intervention in many of these commodities, by making loans, reducing acreages, and taking surpluses off the market, has the effect of supporting prices.

Rubber Quotas Cut Sharply

Rubber has had one of the sharpest advances of any commodity, with a rise of 3½c from the low point reached in April. Since the end of last year the committee administering the international agreement, by which over 90 per cent of world shipments are controlled, has cut export quotas successively from 90 to 70, 60 and, for the third quarter of this year, 45 per cent of the base allowance. This rate provides the market with the smallest supply in six years. Including the non-agreement countries, it allows shipments of hardly more than 700,000 tons annually. Not since 1932 has the world used so little rubber, and in 1937 it used nearly 1,100,000 tons. A reasonable estimate of world consumption in 1938 is 850,000. If the 45 per cent export rate should be continued through the fourth quarter, stocks might be reduced during the second half year by 75-80,000 tons. This is significant improvement.

It can hardly be doubted that the long trend of rubber consumption is still upward. The weight of rubber in tires is increasing, the use of rubber tires on tractors and farm implements is gaining, the number of motor vehicles in the world (barring a temporary setback in the United States) is rising, and the non-tire uses of rubber are expanding greatly. The Commodity Exchange estimates that in 1929 only 73,000 tons of rubber was used in this

country for products other than tires, while in 1937 the figure was 135,000 tons.

Taking a conservative view of consumption prospects, the opinion is warranted that the 45 per cent export rate, if continued indefinitely, would produce much higher prices. The next question is what action the Committee will take hereafter.

Non-Ferrous Metals Production Reduced

The metal markets have strengthened with other commodities. Tin has risen sharply upon the reduction in the export quota to 45 per cent and the decision to segregate a part of these shipments in a "buffer pool." Lead and zinc have both been marked up, and the copper market shows a stronger tone due to a rise in the London price.

The domestic copper price has dropped from the peak of 17c fifteen months ago to 9c currently, with consumption off in all classifications, and the present outlook for consumption is not particularly encouraging. The trend of visible refined stocks has continued upward with a rise of 14,000 tons in May, and they now stand at 369,809 tons compared with 108,585 a year ago. However, fabricators' stocks have dropped, so that the over-all position is not as much worse as appears from these figures. Seemingly a balance between production and final consumption is now being reached. In June all producers cut mine production further, with Kennecott shut down completely for at least a month. In due course this curtailment will further reduce the refinery output. The chief market risk meanwhile is that some of the copper refined from scrap which has been moving abroad may back up in the domestic market. However, the London price has strengthened sharply, and at this writing is above New York. The cartel producers supplying the foreign market have cut their quotas from 105 to 95 per cent effective July 1st, which will reduce mine output abroad 7,000 to 8,000 tons monthly.

Zinc and lead stocks have both continued to rise. Zinc stocks are the highest on record. The promising factor is that production of concentrates in the tri-state area has been curtailed sharply and mining operations in other places have been cut. Lead stocks are in strong hands, and the statistical position has not weakened as much as in other commodities.

Prices of non-ferrous metals normally move in the same direction as the general business curve. The metals have varied uses in many industries and demand for them rises and falls with industrial operations. Moreover, they go into durable goods, where the widest fluctuations of business take place. Hence they are sensitive business indicators. Steel scrap, likewise sensitive, has rallied sharply.

Textile Fiber Prices Supported

Textile fibers, except rayon, are agricultural products. Only in rayon has production been curtailed as sharply as the commodities already mentioned. Rayon yarn manufacturers, however, have good sized stocks, and have cut prices to the lowest on record. They look to Fall improvement in weaving operations to take excess stocks off their hands.

The cotton situation is complex for brief description. Looking ahead, the important influence on the price is the fact that under the Farm Act as amended a Government loan becomes mandatory under either of two conditions: (1) If the price at any time during the coming season averages less than 52 per cent of "parity." Estimating "parity" at 16c, a loan will have to be offered if the price drops below 8.32c, average of the ten Southern markets. (2) If the August crop forecast exceeds a normal year's domestic consumption and exports, which is about 13 million bales.

Unless the crop is a failure it seems that the first of these conditions will at some time be fulfilled, and that there will be a loan of at least 8.32 cents. If the crop is too small to bring the loan provisions into use prices should advance naturally, until checked by withdrawal of cotton from the 1937 loan. It is difficult to say at what price cotton may be attracted from the loan stock, but grades which command a premium in the market (for which no special provision is made in the loan) might move out at 9½c, and the non-premium grades at a somewhat higher figure. This is a rough indication of the probable price range of the coming crop, although there are other factors in the market.

The season has been a disappointing one from the standpoint of consumption, with little prospect that the world use of American cotton for the twelve months ending July 31st will materially exceed 11,000,000 bales. Consumption of foreign cotton also has declined and the world carryover will be the largest ever known. With the Government holding 7 million bales it is certain that cotton is bringing a price above what its value would be in a free and open market, and the loan stock is likely to act as a price depressing factor for a long time to come.

The wool market also is supported by a Government loan, which is close to the price now ruling for new clip wools in the West. Total wool stocks in the country are large but stocks in manufacturers' hands are small. Prices are substantially below an import basis and importations of foreign clothing wool will therefore continue negligible. Thus revival of woolen manufacturing operations would gradually absorb the present surplus. Over the long run the situation will right itself, and the loan limits the possibility of further decline.

Wheat Surplus In Prospect

The wheat situation is always of major interest in this country for wheat is a large cash crop and the main crop over great areas, although it contributes a smaller share of farm income than many people believe. The Government crop estimate on June 1st placed the Winter wheat yield at 761,000,000 bushels and stated that in Spring wheat the prospect indicated between 260 and 285 million. This would total over one billion, the largest wheat crop in our history. However, crop reporters now agree that the Winter wheat outturn will not be as large as expected, due to effects of earlier damage which is showing up in the harvesting returns. Spring wheat is still some distance from harvest.

Nevertheless, if the crop should be as much as 900 million bushels the surplus will be large. Domestic requirements are normally about 670 million. The export outlook is problematical. Europe is expecting to buy more wheat than last year but Canada has indications of a bumper crop, the present prospect in the Argentine is good, and as the American price will be pegged by a Government loan this country may not get much benefit from export trade. Narrower differences between our markets and Liverpool already show the effects of the coming peg. Probably there will be a considerable surplus to add to the indicated July 1st carryover of 200 million bushels, itself larger than average.

Details of the Government loan are now being awaited. The loan must equal, according to the formula set forth in the Farm Act, 52 per cent of the farm parity price, which works out at 60c on the farm. What the Chicago and Kansas City equivalent will be will depend upon the details of the loan.

If the Government accumulates a stock of wheat as it has of cotton, and holds the price above the figure at which competing countries are willing to sell, it is difficult to see how the problem will eventually be solved. The formula for calculating the acreage goal for next year as given in the Farm Act would require a reduction of almost one-half from the acreage this season. Recognizing the hardships that this would work, and that it might be impossible to obtain such a drastic cut, Congress amended the Farm Act to fix the minimum acreage required by the 1939 program at 55,000,000. Even this in the opinion of competent judges can be viewed only as a goal.

Corn prices have been stable, due largely to exports and the loans that have been made on corn in farm cribs; and since another loan is practically assured in 1938 continued price stability is in prospect. Hog slaughter is running lighter than had been expected; as supplies will decrease in the next two or three months firm prices are looked for until the seasonal decline when the Spring pig crop moves to market in the Fall. The Department of Agriculture expects prices of grain-fed cattle to hold firm or advance seasonally, although the lower grades may decline.

The statistical position of hides is more satisfactory than of most other commodities. Total stocks of hides and leather have declined about 10 per cent since the end of January and at the end of April were well below average. Tanners' stocks of hides are small. Shoe production in the earlier part of this year was the smallest since 1933; and if reduced stocks lead to a pickup in operations the hide and leather markets can be expected to improve.

Only bare mention can be made of other commodities. The silk market has been almost featureless. Sugar continues depressed, for the supply in the world markets is abundant and quotas for the United States exceed consumption requirements. Cocoa has rallied after dropping about 70 per cent in a little over a year, but supplies are unprecedentedly heavy. Coffee has not improved and the fats and oils have not changed much.

Commodities and the Economic Situation

The purchasing power of many people and of whole countries has been reduced by the decline in prices of commodities which provide their chief sources of income. It goes without saying that the rubber growers are less prosperous with 13 or 14 cent rubber and 45 per cent shipment quotas than they were with rubber above 20c during a good part of last year and quotas as high as 90 per cent. The income of the coffee producers is diminished by around 40 per cent; the wool growing countries have a price 25 per cent lower and their sales have slumped badly. In some degree this applies to the producers of sugar, cocoa, hides and fats, and to the grain and meat growers and exporters.

This is an important factor in the world economic situation. However, the price decline has been in no sense as disturbing as that after 1929, which visited distress on every country, started the vicious circle of currency depreciation, and almost wrecked the world economy. The decline then started from a plateau upon which prices had rested during eight years, 1922-1929, upon which a fair equilibrium had been worked out, investments made and debts created, and which became accepted in the public mind as permanent. The breakdown of the existing relationships was of unexampled severity.

The present decline, however, started not only from a lower level than in 1929 but from a temporary peak which had climaxed a brief advance, to wit, a rise of about 40 per cent in nine months in the Moody index. Commodity producers had not enjoyed the peak prices for

long. They had not created new productive facilities, based upon expectation that prices would be permanent, nor had they contracted new debts. In the farm areas in this country the period was one of debt repayment.

These differences explain why the price decline, although more severe, has been less disturbing in international business than was the drop in the earlier depression. Now a turn may be in the making. The way out in past depressions has often been provided by a rise in staple prices, which gives producers more purchasing power and starts the flow around the circle.

It should be emphasized, however, that a turn in prices will not mark a turn to prosperity unless it is the forerunner of greater production and greater consumption. It is not sufficient merely to support markets by Government fiat, by artificial and extreme curtailment of output which leaves producers and resources unemployed, or by expenditures of Government funds which represent heavier taxes or greater debts. These devices may balance the market position, but if they do it by reducing the employment of productive resources, they will in the long run reduce the general standard of living, and tend to become unsupportable. The difference is between achieving a balance upon a scarcity basis and one upon a basis of abundance. The mining towns and the laborers on plantations, who are out of work, will understand the difference between the two terms, and what they mean in terms of living.

On the other hand, if the price turn is signalling a change in the economic situation which will lead in due course to increased production, it is a reassuring and hopeful development.

Monetary Factors

As a final comment on the commodity situation, some readers may notice the absence of monetary factors and the well worn subject of inflation from this discussion. The omission is intentional. It is doubtful whether buyers who have been influenced greatly by inflationary expectations, during the past few years, have profited from this reasoning as much as they have lost. Certainly belief in the power of monetary factors led many to over-buy and over-stay the markets during the 1936-37 advance.

The fact is that over any calculable period which is important in practical buying policies, the ordinary factors of supply and demand are far more significant in price trends than inflationary factors such as an assumed relationship of commodity prices to gold, or the huge banking reserves and theoretical possibilities of credit expansion, or other conditions. (A currency debacle is of course another story). Price advances take place when demand encroaches on supply, and become especially rapid as demand begins to force the productive plant to capacity. These are the influences, together with the will to spend or invest, or the psychological factors, which count in practical matters.

Money and Banking

The outstanding feature of the banking situation continues to be the rapid pumping of additional funds into the money market under the Government's program for promoting credit expansion. Since the middle of April, when the proceeds of desterilized gold were transferred to the Federal Reserve Banks, the Treasury has been using this money, in conjunction with regular receipts, to meet running expenses, purchase additional gold offered and retire debt, with the result that the total of these spendable balances has been reduced from a peak of $1,428,000,000 just after desterilization to $928,000,000 on June 22. As this money has been paid into the market it has added to bank reserves, and, together with the reduction of approximately 13¾ per cent in reserve requirements put into effect on April 16, has raised excess reserves by more than a billion dollars to $2,780,000,000 on the 22nd, a new "high" since the first increase of reserve requirements in August, 1936.

Even so it is evident that excess reserves are still far short of the potential peak. Apart from over $900,000,000 of the proceeds of desterilization remaining unspent, the Treasury holds something over $100,000,000 of gold acquired over the past two months for which it has not yet reimbursed itself by depositing gold certificates with the Federal Reserve Banks. Thus, altogether, there is available from gold over a billion dollars, the expenditure of which over coming weeks may carry excess reserves to $3,500,000,000 or more, not counting additional gold imports which might expand considerably should conditions in this country develop in a manner to attract a new capital inflow.

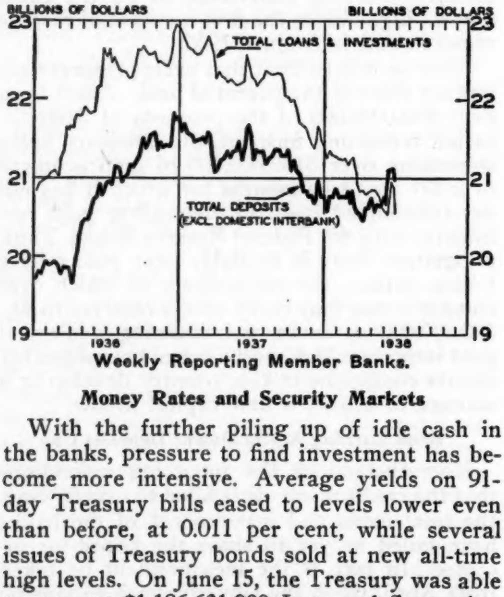
Bank Earning Assets Down; Deposits Up

Notwithstanding the foregoing indications that the credit reservoir is filled to overflowing, the total loans and investments of the banks have failed as yet to show the hoped-for increase. In fact, if the measurement be taken from April, when the Government's expansion program was initiated, it will be found that total loans and investments of the commercial banks have declined. Evidence of this appears in a decrease of approximately $250,000,000 during this period in the total earnings assets of the weekly reporting member banks to the lowest point since 1935.

The reason for this may be found partly in the Treasury's policy of utilizing desterilized gold to retire Treasury bills, but also in the fact

that business has been slow and business men, by and large, have had no incentive to seek additional credit. While the banks have plenty of money and are eager to employ it profitably, they have been unable under the conditions to find suitable outlets, loans have continued to decline and bank earnings have suffered accordingly. The truth is that business men borrow when they think they can use money to advantage, and in the absence of such conditions are not likely to incur obligations merely because money is cheap.

During the first part of June total earning assets of the reporting banks experienced a sharp increase, largely because of temporary borrowings at New York City in connection with Treasury financing on the 15th. Most of this increase, however, was wiped out later, and for the next few weeks the trend may be downward owing to continued redemption of Treasury bills, with a turn probable in the latter part of July when the Treasury is scheduled to resume borrowing in the open market. Already, as the accompanying chart shows, deposits have begun to reflect the expansive effect of Government spending and should increase more rapidly as the lending-spending program gathers momentum.



Weekly Reporting Member Banks.

Money Rates and Security Markets

With the further piling up of idle cash in the banks, pressure to find investment has become more intensive. Average yields on 91-day Treasury bills eased to levels lower even than before, at 0.011 per cent, while several issues of Treasury bonds sold at new all-time high levels. On June 15, the Treasury was able to convert $1,186,631,000 June and September notes into 2¾ per cent 20-25 year bonds and 1⅛ per cent 5-year notes, these coupons marking new low rates for comparable maturities. Exchanges were effected in the ratio of more than three to one in favor of the bonds over the notes, with both issues subsequently quoted at substantial premiums.

High grade corporation bonds were generally strong except in the case of rail issues, which suffered during the early part of the month from the failure of Congress to pass railway relief legislation before adjourning. The real sensation, however, was the sharp come-back in lower grade bonds, especially the rails, late in the month, accompanying the strong rally in the stock market. Between June 18 and June 29, the Dow-Jones average of ten second grade railroad bonds rose from 40.77 to 48.75, or by one-fifth.

The resumption of activity in the capital market continues to be one of the most encouraging features of the situation. Led by the $100,000,000 United States Steel and $73,000,000 Commonwealth Edison financing, the total of new bond offerings exceeded $300,000,000, the most impressive monthly showing since a year ago. In addition to public flotations, an important volume of new issues continues to be placed privately with large institutional investors, chiefly the insurance companies, this procedure eliminating expenses incident to registration and underwriting.

As to be expected at this stage, the bulk of the securities thus far brought out or pending consists of securities of the higher ratings, and represents refinancing rather than the raising of new capital, a conspicuous exception to the latter statement being the United States Steel bonds, half of which called for new money. This, of course, is good as far as it goes, but what is needed also is a market in which capital is available for enterprises involving some risk. To bring this condition about, however, requires something more than cheap money,—namely, the prospect of operating at a profit. It is one thing to coax borrowers into the market for the purpose of scaling down debt charges, and another thing to induce business to seek new capital, or investors to supply it, when there is doubt as to the outcome of business ventures or as to the tax upon them if successful.

Reflecting the favorable reception accorded recent issues, more than $200,000,000 of new financing is already scheduled for July, with indications that the total may be increased by registrations still to be filed with the S.E.C. Of offerings soon to be announced, the largest comprises $85,000,000 Standard Oil Company of New Jersey debentures and serial notes, which is significant not only by reason of size but also in that the $50,000,000 of 15-year debentures will bear 2¾ per cent, marking the first instance of breaking the 3 per cent coupon rate for a long-term corporate issue.

A reminder of the problems facing investors as result of the continued low interest rates appears in the announcement by leading life insurance companies that returns will be reduced on single premium annuity policies written after July 1.

Taxes and National Income

The record peace-time appropriations voted by Congress and the passage of a new tax bill, following closely the approval in England of a 1938-39 budget providing for larger expenditures and higher taxes, have brought the subject of taxes again to the fore and revived the question of relative tax rates in the two countries. New estimates of our national income, which bears an important relationship to tax collections, have also been made available by the Department of Commerce during the past month.

Individual Income Taxes

In the United States, the Revenue Act of 1938, which became law without Presidential signature, revised the treatment of capital gains and losses of individuals in response to widespread criticism of the former method, on the grounds that it discouraged seriously the investment of capital in new enterprise. Under the old law, if a venture proved successful, the Government took a share of the profit, but if a loss resulted, it was not deductible, except up to $2,000. In the case of individuals in the high surtax brackets, the odds against them on business ventures, which involve the possibility of loss as well as profit, became practically prohibitive. The profit on undertakings that had been developing over a period of years usually was "established" for tax purposes in the year in which the transaction was completed, which lifted the taxpayer to a much higher bracket for that particular year and, together with state and other levies, often took a large part of the gain that had accrued.

The former inequalities on long-term transactions are lessened somewhat in the new Revenue Act by giving (in effect) optional rates of 15 and 20 per cent on capital gains and by permitting net capital losses to be offset to a larger extent against other income. In short-term transactions, however, the taxpayer will in some ways be at a greater disadvantage than heretofore.

Following is a condensed summary of the normal income tax and surtax rates for individuals as prescribed by the principal revenue acts passed since the Federal Government was given power by constitutional amendment in 1913 to levy a tax upon individual incomes. Due to continual changes in the detailed provisions of tax legislation and regulations relating to income from different sources, and to the deductions, exemptions and credits permitted by law, the figures for different years are not strictly comparable. Nevertheless, they show the modest rates in effect at first, the abrupt rise during wartime, the series of reductions following the war and the recent rise to maximum rates that exceed even the 1918 peak.

Individual Income Tax Rates Applicable to Citizens and Residents of the United States

Revenue Act of	Personal Exemptions Single	Personal Exemptions Married	Normal Tax Rates	Surtaxes Begin At	Surtaxes Range of Rates	Maximum Normal & Surtax
1913........	$3,000	$4,000	1%	$20,000	1-6%	7%
1916........	3,000	4,000	2	20,000	1-13	15
1917........	1,000	2,000	2-4	5,000	1-63	67
1918........	1,000	2,000	4-12	5,000	1-65	77
1921........	1,000	2,500	4-8	6,000	1-50	58
1924........	1,000	2,500	2-6	10,000	1-40	46
1926........	1,500	3,500	1½-5	10,000	1-20	25
1928........	1,500	3,500	1½-5	6,000	1-55	60
1932........	1,000	2,500	4-8	6,000	1-55	63
1934........	1,000	2,500	4	4,000	4-59	63
1936........	1,000	2,500	4	4,000	4-75	79
193[illegible]	1,000	2,500	4	4,000	4-75	79

Source: Compiled from Treasury Department "Statistics of Income" and from Revenue Acts.

As the Revenue Act of 1938 makes no change in the rates for individuals, the tax on large incomes remains so high that the net yield *after* taxes from corporate bonds and stocks, or from ordinary business and real estate ventures, is often lower than the yield from tax-exempt bonds. This condition discourages large investors and their trustees from investing capital in productive enterprise, and places a premium on the purchase of state and municipal obligations instead.

Corporate Income Taxes

The normal income tax for corporations earning $25,000 and upwards has been raised (in effect) from 15 per cent to 16½ per cent, with an increase also in the preferential rates for small corporations. At the same time, the surtax on income not paid out in taxes or dividends was lowered from the 7 — 27 per cent scale to a flat 2½ per cent, and under the new law will apply only to corporations earning more than $25,000.

Inasmuch as four-fifths of all corporations in this country, taking an average of all years since the war, have earned less than $5,000 annually or operated at a deficit, only a relatively small percentage of the total number will now be liable for payment of the surtax on undistributed income. This numerically small group, however, comprises the leading corporations in the major lines of business, and makes up an important share of total corporate activity, as measured by volume of goods and services produced, employment and payrolls, raw materials and supplies purchased, invested capital, taxes paid, etc.*

While the management of large business concerns will still be under some pressure to distribute all profits, in the years when there are profits, rather than applying them to build up surplus and reserves, the penalty for retaining a portion of earnings will be much less costly than in 1936-37.

The Sum-Total of Taxes

Neither income tax rates nor total taxes collected by the Federal Government measure

*See "The Distribution of Corporate Income" in Bank Letter for December, 1937, pages 165 - 167.

fully the pressure of taxes upon business and upon the standard of living. This is because relatively so few people pay federal income taxes and so many of the other taxes collected by all federal, state, municipal, county, special district and other government authorities — numbering altogether some 175,000 — are indirect or "hidden" taxes. The latter are paid for by the public as part of the cost of rent, food, clothing, fuel, transportation, electric power, telephone service, insurance premiums, — in fact, practically every type of goods and services purchased.

The total tax load has been increased and spread over a much broader base in recent years through the imposition of federal old-age benefit taxes and state unemployment taxes under the social security program, and of state and municipal sales and income taxes for financing relief expenditures.

In 1937, the net tax collections of the Federal Government were approximately $5,029,000,000, but the tax collections of state and local governments were estimated to exceed this figure by $2,242,000,000, and to total $7,271,000,000. The grand total of taxes paid by the American people last year was $12,300,000,000, of which federal taxes represented about 41 per cent and state and local taxes the remaining 59 per cent.

British Tax Collections

In comparing the tax collections of the United States with those of Great Britain, an important consideration is the large share of total taxes in the United Kingdom (England, Scotland, Wales and Northern Ireland) that is collected by the National Government, which later remits funds to the counties and municipalities. Out of total tax collections of approximately £1,017,000,000 last year, the National Government collected £841,000,000, or 83 per cent, and local governments only £$176,000,000, or 17 per cent. Because of this wide difference in method of governmental finance, a simple comparison of tax collections and tax rates of our Federal Government with those of the British Government is misleading.

In the following table we give a summary of all tax collections in the United States and the United Kingdom and their relation to national income, compiled from studies of the National Industrial Conference Board.

It will be seen that the preliminary total of $12,300,000,000 collected in the United States last year was more than twice the British total, converted at $5 = £1.

The average per capita tax in the United States last year was $95.16 on an estimated population of 129,257,000, which was only moderately smaller than the British average of $107.55 on a population of 47,288,000.

Tax Collections in the United States and the United Kingdom
(000,000's Omitted)

United States

Year	Tax Collections Federal	Local	Total	National Income	Taxes to Natl. Inc.
1926......	$3,207	$5,398	$ 8,605	$73,473	11.7%
1927......	3,337	5,722	9,059	73,913	12.3
1928......	3,194	6,148	9,342	75,847	12.3
1929......	3,328	6,431	9,759	79,438	12.3
1930......	3,468	6,798	10,266	72,340	14.2
1931......	2,717	6,583	9,300	60,122	15.5
1932......	1,789	6,358	8,147	46,546	17.5
1933......	1,786	5,715	7,501	44,358	16.9
1934......	2,892	5,881	8,773	51,052	17.2
1935......	3,546	6,185	9,731	55,700	17.5
1936......	3,847	6,651	10,498	63,790	16.5
1937......	5,029	7,271	12,300†	67,544	18.2
1938......	6,053†	—	—	—	—

United Kingdom

Year	Tax Collections National*	Local	Total	National Income	Taxes to Natl. Inc
1926......	£ 664	£ 182	£ 846	£4,173	20.3%
1927......	693	191	884	4,359	20.3
1928......	685	191	876	4,339	20.2
1929......	677	177	854	4,384	19.5
1930......	704	171	875	4,318	20.3
1931......	733	168	901	3,889	23.2
1932......	728	167	895	3,844	23.3
1933......	709	170	879	3,962	22.2
1934......	710	176	886	4,238	20.9
1935......	739	176	915	4,530	20.2
1936......	783	176	959	4,850†	19.8
1937......	841†	176	1,017†	5,200†	19.6
1938......	886†	—	—	—	—

Source: Compiled from National Industrial Conference Board studies on "Cost of Government in the United States". *Figures of the National Government are for fiscal years ended the following March 31. †Preliminary or estimated.

Ratio to National Income

Measurement of the total tax load must take account of ability to pay, and the best over-all measure of taxes is the percentage they bear to national income, which for 1937 was estimated at $67,544,000,000 in the United States and at £5,200,000,000 in Great Britain, giving ratios of 18.2 per cent and 19.6 per cent, respectively. It is somewhat striking to discover that, whereas in 1926 the percentage of taxes to national income in the United States was little more than half as high as in Great Britain, our ratio has been rising so rapidly that it was almost as high last year as that of Great Britain. The increase in estimated tax collections in the United States to a new all-time high this year, and the sharp decline thus far in national income, indicate a still higher ratio for 1938.

The estimates of national income computed by the Department of Commerce*, and just published for 1937, differ slightly from the

*See "National Income in 1937 Largest Since 1929" in Survey of Current Business, June 1938. For a comprehensive discussion of the concepts, scope and limitations of the national income estimates as well as the sources and methods of estimation, the reader is referred to a volume entitled, "National Income in the United States, 1929-35" published in 1936 by the Department of Commerce. Copies of these publications may be obtained from the Superintendent of Documents, Washington, D. C., or from any District Office of the Bureau of Foreign and Domestic Commerce, for 15 cents and 25 cents per copy, respectively.

series of the National Industrial Conference Board used above and, although available only since 1929, are accompanied by tables showing in detail the distribution of income according to industrial divisions and according to types of payment.

Despite the sharp decline in business that occurred during the latter part of 1937, national income for the year as a whole showed a further recovery to a point within 12 per cent of the 1929 level.

Of the total national income paid out last year, 67.4 per cent was paid or accrued to employes in the form of wages, salaries, work-relief wages, social security contributions of employers, and other labor income. The percentage of labor income rose in 1937 to the highest point in the nine-year period covered by the Department of Commerce computations, and compares with 66.9 per cent in 1936, 64.4 per cent in 1932 and 65.6 per cent in 1929.

Income of all other types, including dividends, interest, entrepreneurial withdrawals, net rents and royalties — a large share of which goes to labor indirectly via the banks, insurance companies and individual investments—showed a corresponding decrease in its proportion of the total, amounting to 34.4 per cent in 1929 and 32.6 per cent in 1937.

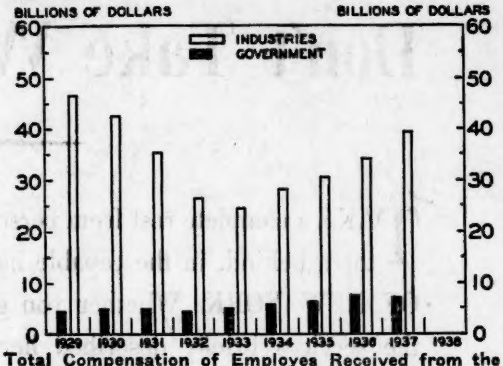
An analysis of labor income according to sources reveals the growing importance of income derived from government employment, including work-relief wages, as compared with income from the industries. Figures showing the changes by principal groups between 1929 and 1937 are given in the following table, while the creeping advance in the relative size of the government groups is shown in the accompanying chart.

Total Compensation of Employes, by Industrial Groups

(In Millions of Dollars)

Industrial Groups	1929	1937	Per Cent Change
Agriculture	$ 1,313	$ 742	—43.5
Mining	1,508	1,197	—20.6
Manufacturing	14,770	13,381	— 9.4
Construction	2,722	1,314	—51.7
Transportation	4,886	3,833	—21.6
Electric light, gas	500	498	— 0.4
Communication	707	610	—13.7
Trade	8,079	6,211	—23.1
Finance	2,531	2,228	—12.0
Service	6,565	5,527	—15.8
Miscellaneous	2,197	1,877	—14.6
Social security	......	923	+ ....
Other labor income	937	1,117	+19.2
Total Industrial	$46,715	$39,458	—15.5
Government Groups			
Federal Government	1,398	1,918	+37.2
State governments	342	469	+37.1
City governments	1,167	1,102	— 5.6
County, township, etc.	376	396	+ 5.3
Public education	1,511	1,525	+ 0.9
Work-relief wages	......	1,860	+ ....
Total Government	$4,794	$ 7,270	+51.6
Grand Total	$51,509	$46,728	— 9.3

Source: Condensed from U. S. Dept. of Commerce Study of National Income in the United States, published in Survey of Current Business, June, 1938, Table 5.



Total Compensation of Employes Received from the Industries and from Government

Thus, while labor income last year from such industries as agriculture and mining, manufacturing and trade, public utilities and finance, construction and services together were still 15.5 per cent below the 1929 level, the total labor income from the government groups had risen 51.6 per cent *above* the 1929 level. This reflects the growing number of government employes and others who derive their support from tax funds, and the reduced number and income of people gainfully occupied in the industries producing goods and services.

Comparison of Public Debts

Even the relative tax loads in the United States and England do not tell the whole story, unless the respective government budgets are in reasonable balance. If actual expenditures are in excess of current tax collections, with the deficit financed by borrowing, it means that the liability for higher taxes is accruing, even though their payment is being postponed. Since 1930 the combined debt of all governments in the United Kingdom has increased from approximately £8,960,000,000 to £9,523,000,000, or by 6.3 per cent. In the same period, the combined debt of all governments in the United States (not including guaranteed debt) rose from approximately $34,170,000,000 to $55,579,000,000, or by 63 per cent, and now exceeds that of the United Kingdom.

The $21,409,000,000 debt increase in the United States reflects the extent by which the increase in taxation lagged behind the expansion in government expenditures.

Total public debt in this country now amounts to $429.99 per capita, as compared with £202.25, equivalent to $1,011.25 per capita, for Great Britain. The fact that the British, carrying more than twice as large a per capita debt as ourselves, pay only moderately heavier per capita taxes, is evidently due to a lower level of government operating expenses — exclusive of interest — than in this country.

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